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C O N F I D E N T I A L CARACAS 000103

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SUBJECT: CHAVEZ TURNS UP THE HEAT ON CENTRAL BANK FOR
TRANSFER OF RESERVES

REF: 03 CARACAS 3941

Classified By: Ambassador Charles S. Shapiro for reasons 1.4(b) and (d)

Summary

1. (C) President Chavez has renewed his struggle with the Central Bank over USD 1 billion in international reserves, which he has demanded be handed over to the GOV for agricultural spending. The Bank has to this point resisted, citing controlling legal restrictions. The National Assembly joined the fray January 7 with a non-binding resolution passed on partisan lines urging the Central Bank to comply with Chavez's request. Despite the political upside for Chavez in this fight, the downside for Venezuela's economy if he succeeds in tapping the reserves would be severe. End summary.

Chavez Hits BCV (Again)

2. (U) In his December 28 "Alo, Presidente!" telecast, President Chavez renewed his call for the Central Bank of Venezuela (BCV) to transfer USD 1 billion of its USD 21 billion in international reserve holdings to the GOV for use in "agricultural reactivation." Since then Chavez has used every public appearance to repeat his demand. Chavez cites provisions of the 1999 Constitution that generically require the BCV to promote the overall economic health of the country, including agriculture. (Note: Article 320 of the Constitution and Article 32 of the Central Bank Law specifically prohibit the BCV from using reserves to fund GOV budgetary items. End note.) He has continued his threats to appeal to the Supreme Court or call for a referendum on the issue if the BCV does not yield. In one major difference from his November statements on the issue (see reftel), Chavez has specifically targeted the corn and sugar sectors for receipt of the funds. He has not been specific about what the process for distribution of the funds would be.

Agricultural Credit Problems

3. (U) The conflict between the President and the BCV over the "millardito" (little billion), as Chavez calls the demanded amount, exists against the backdrop of a struggling agricultural loan program. The Special Plan for the Resupply of Agriculture is an agreement between the BCV, the Ministry of Finance, and commercial banks that requires agricultural credits be 12 percent of bank loan portfolios. According to the plan, these loans are to have a preferential "agricultural interest rate" calculated at 85 percent of the rate for oil project loans. This rate currently stand at approximately 16 percent, which is about 10 percent below the prime lending rate. Banks that do not meet the required percentage in their loan portfolios face fines; most are gladly paying the fines rather than issue high-risk, low and even negative return loans.

BCV Holds Firm

4. (U) The BCV has been steadfast in its refusal to bow to pressure from Chavez. BCV President Diego Castellanos and Director Domingo Maza Zavala both made statements to the press December 29 that said any such transfer would violate the Constitution and that they would welcome a Supreme Court ruling on the matter. Following a pro-Chavez "millardito" demonstration outside the BCV January 7, the bank issued a statement to the press and to all diplomatic missions, including the embassy, that detailed the constitutional and other legal restrictions on the use of international reserves to finance government spending. (Note: The BCV statement characterized the agricultural loan program as having

"satisfactory results." End note.)

National Assembly Speaks

15. (U) The National Assembly passed a resolution January 7 urging the BCV to transfer the reserves. The expected partisan wrangling colored the debate over the non-binding resolution. MVR Deputy Willian Lara echoed Chavez when he claimed the transfer was legal under the provisions of the Constitution requiring the BCV to support national economic development. Opposition deputies were dubious about the prospects for meaningful results from a prospective draw down of reserves; Proyecto Venezuela Deputy Vestalia de Araujo noted that the administration has had five years to improve the agricultural sector and has failed. The resolution passed by a vote of 51 to 37. Pro-Chavez members of the Assembly plan to deliver the resolution to the BCV during a march January 11.

Chavez Speech Rattles Bond Issue

16. (U) The fallout from the Chavez/BCV conflict has been felt as far away as New York. The GOV issued USD 1 billion in new 30-year bonds January 7 (details septel). In an almost disastrous alignment of events, a Chavez speech in Zulia state at the inauguration of a food processing facility in which he railed against the BCV sent a momentary jitter through the bond operation. The Ministry of Finance quickly issued a statement clarifying Chavez's position with assurances that all funds from the BCV were subject to legal controls that the GOV had no intention of violating. Finance Minister Nobrega claimed January 8 that the executive branch was only seeking to utilize "unused assets" from the BCV's monetary desk.

Comment

17. (C) This issue is a win/win demagogic jewel for Chavez in the short term. The vast majority of his intended audience has little understanding of the importance of BCV independence. Therefore, he is able to frame this issue squarely in terms of elite "haves" keeping down poor "have-nots." The message requires others to engage in damage control as Nobrega's tortured explanation to international financial markets illustrates. The ultimate danger lies not in this first attempt to commandeer the BCV's reserves, but in the addictive effect it could have on future GOV budget operations. This administration does not have a good track record of fiscal responsibility; the laudable Macroeconomic Stabilization Fund (FIEM) intended to protect against oil price shocks has disappeared with little accountability at a time of record oil prices. A policy of artificially high, exchange control-fueled reserves is an invitation to even higher inflation that was already 27.1 percent in 2003. Our agricultural contacts, as well as our FAS counselor, are highly skeptical that any of the proposed transfer would become productive investment in that troubled sector.
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